

Message Text

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ACTION TRSE-00

INFO OCT-01 EA-07 ISO-00 CIAE-00 PM-04 H-02 INR-07 L-03

NSAE-00 NSC-05 PA-01 PRS-01 SP-02 SS-15 USIA-06

AID-05 COME-00 EB-07 FRB-03 XMB-02 OPIC-03 CIEP-01

LAB-04 SIL-01 OMB-01 STR-04 CEA-01 NEA-10 IO-11 INT-05

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P R 180255Z MAR 76

FM AMEMBASSY MANILA

TO SECSTATE WASHDC PRIORITY 3141

INFO AMEMBASSY SEOUL

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USADB

FOR NAC AGENCIES

E. O. 11652: ADS, DECLAS 6/17/76

TAGS: EAID, EFIN, KS

SUBJECT: PROPOSED ADB LOAN FOR COAL DEVELOPMENT PROJECT

SUMMARY: ADB MANAGEMENT PROPOSES \$12.0 MILLION EQUIVALENT LOAN FROM ORDINARY CAPITAL RESOURCES TO DAI HAN COAL CORPORATION (DHCC) WITH GUARANTEE OF REPUBLIC OF KOREA TO FINANCE FOREX COST OF REHABILITATION AND EXPANSION OF EXISTING COAL MINES OF DHCC. PROJECT IS AIMED AT INCREASING INDIGENOUS COAL PRODUCTION FOR DOMESTIC HEATING TO HELP MEET KOREA'S ENERGY NEEDS AND IS IN ACCORDANCE WITH GOVERNMENT'S STRATEGY TO MINIMIZE FOREX EXPENDITURES ON COSTLY IMPORTS OF CRUDE OIL. USADB RECOMMENDS FAVORABLE NAC ACTION.

1. ADB DOC R23-76 WITH ATTACHMENTS DESCRIBING

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PROPOSED LOAN POUCHED ADDRESSEES MARCH 11. BOARD

CONSIDERATION SCHEDULED MARCH 30, 1976.

2. ADB MANAGEMENT PROPOSING \$12.0 MILLION LOAN FROM ORDINARY CAPITAL RESOURCES FOR COAL DEVELOPMENT PROJECT IN KOREA. PROCEEDS WILL FINANCE FOREX COST OF (A) PROCUREMENT OF MINING EQUIPMENT AND FACILITIES AND (B) PROVISIONS OF FOREIGN TECHNICAL EXPERTS TO ASSIST DHCC IN INITIAL IMPLEMENTATION OF PROJECT AND PREPARATION OF LONG-RANGE OPERATING PROGRAM FOR DEVELOPMENT OF ITS COAL MINES. PROPOSED TERMS ARE 15 YEAR AMORTIZATION INCLUDING 3 YEAR GRACE PERIOD, 8-3/4 PERCENT INTEREST. DHCC TO BE BORROWER AND EXECUTING AGENCY AND REPUBLIC OF KOREA TO BE GUARANTOR.

3. COMBINATION OF RAPID INDUSTRIALIZATION, INCREASING POPULATION AND IMPROVED LIVING STANDARDS DURING 1965-1973 PERIOD RESULTED IN 9.7 PERCENT ANNUAL AVERAGE GROWTH RATE OF ENERGY CONSUMPTION IN KOREA. HOWEVER, FOLLOWING ONSET OF OIL CRISIS IN 1973, ENERGY CONSERVATION MEASURES WERE INSTITUTED THAT HELD 1974 INCREASE IN ENERGY CONSUMPTION TO 1.4 PERCENT.

4. WHILE IMPORTED PETROLEUM-BASED FUEL ACCOUNTS FOR MORE THAN 50 PERCENT OF COUNTRY'S ENERGY CONSUMPTION, DOMESTIC COAL PRODUCTION (31.6 PERCENT OF TOTAL ENERGY CONSUMPTION IN 1974) HAS ALSO PLAYED IMPORTANT ROLE. UNDER GOVERNMENT'S LONG TERM ENERGY PROGRAM INTRODUCED IN MAY 1974, MAXIMUM DEVELOPMENT OF INDIGENOUS COAL PRODUCTION HAS BEEN ACCORDED HIGHEST PRIORITY. OTHER INDIGENOUS ENERGY RESOURCES ARE FIREWOOD AND HYDROPOWER. TO DATE, NO DOMESTIC OIL RESOURCES HAVE BEEN DEVELOPED.

5. TOTAL COAL RESERVES, ALMOST ENTIRELY ANTHRACITE WHICH IS LIMITED TO HOUSEHOLD USE BY PROCESSING INTO BRIQUETTES BECAUSE OF ITS LOW CALORIFIC VALUE, ARE CURRENTLY ESTIMATED TO BE 1,451 MILLION TONS OF WHICH 546 MILLION TONS ARE PROVEN. PRESENT RESERVES ARE CONSIDERED ADEQUATE TO SUPPORT PROJECTED PRODUCTION FOR 23 YEARS, WITH FURTHER EXPLORATION LIMITED OFFICIAL USE

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IN SEVERAL UNEXPLORED REGIONS YET TO BE UNDERTAKEN. LOCATION OF COAL FIELDS IN MOUNTAINOUS REGIONS REQUIRES SUBSTANTIAL CAPITAL INVESTMENT TO INCREASE PRODUCTION, AS WELL AS FOR PROVISION OF RAIL, ROAD AND POWER SERVICES. TOTAL FINANCIAL REQUIREMENTS TO ACHIEVE 1981 PRODUCTION TARGET INCLUDING EXPLORATION, MINE AND RELATED FACILITIES AND ADDITIONAL WORKING CAPITAL ARE ESTIMATED AT \$1.03 BILLION EQUIVALENT.

6. PRIOR TO 1973 OIL CRISIS, GOVERNMENT POLICY OF MAINTAINING LOW COAL PRICE TO PROTECT LOWER INCOME GROUPS DISCOURAGED COAL DEVELOPMENT AND ENCOURAGED DIVERSIFICATION OF ENERGY SOURCES TO OIL. HOWEVER, IN 1974 AND 1975 COAL PRICES WERE RAISED BY 51 PERCENT AND 25.5 PERCENT, RESPECTIVELY, AND GOVERNMENT'S FINANCIAL ASSISTANCE TO COAL INDUSTRY WAS ALSO INCREASED SUBSTANTIALLY SINCE 1974.

7. KOREA'S COAL MINING INDUSTRY PROVIDES EMPLOYMENT FOR 45,000 PERSONS WITH DHCC (A PUBLIC SECTOR COMPANY AND KOREA'S LARGEST MINING COMPANY) EMPLOYING ABOUT 13,350. DHCC IN 1975 PRODUCED ABOUT 29 PERCENT OF COUNTRY'S TOTAL COAL OUTPUT FROM EIGHT MINES. THERE ARE 155 PRIVATE SECTOR MINING COMPANIES PRODUCING 71 PERCENT OF COAL OUTPUT. (GOVERNMENT IS ALSO CONSIDERING ASKING BANK TO PROVIDE ASSISTANCE TO PRIVATE MINES IN FUTURE.)

8. PROPOSED PROJECT TO REHABILITATE AND EXPAND DHCC'S EXISTING COAL MINES IS EXPECTED TO INCREASE ANNUAL PRODUCTION FROM CURRENT LEVEL OF 4.57 MILLION TONS TO 6.18 MILLION TONS IN 1979. PROJECT INCLUDES (A) PROCUREMENT OF MINING EQUIPMENT AND FACILITIES INCLUDING COMPRESSORS, DOZERS, SHOVELS, EXCAVATORS, ROTARY DUMP TRUCKS, LOCOMOTIVES, TUNNELING MACHINES, VENTILATION FACILITIES, PUMPS AND SAFETY EQUIPMENT; AND (B) PROVISION OF TECHNICAL SERVICES, COMPRISING FOUR EXPATRIATE COAL MINING CONSULTANTS FOR APPROXIMATELY 60 MAN-MONTHS, TO ASSIST IN PROJECT IMPLEMENTATION AND TO UNDERTAKE COMPLETE REVIEW OF DHCC'S PROJECTED OPERATIONS FOR DEVELOPMENT OF A LIMITED OFFICIAL USE

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LONG RANG MINE DEVELOPMENT PROGRAM.

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LAB-04 SIL-01 OMB-01 STR-04 CEA-01 NEA-10 IO-11 INT-05

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9. TOTAL PROJECT COST OF ESTIMATED \$19.25 MILLION CONSISTS OF \$12.0 MILLION FOREX COMPONENT TO BE FINANCED BY PROPOSED BANK LOAN AND \$7.25 MILLION LOCAL CURRENCY COMPONENT TO BE FINANCED FROM DHCC'S OWN INTERNAL RESOURCES. FOREX COMPONENT COVERS IMPORTATION OF MINING EQUIPMENT AND FACILITIES AND SAFETY EQUIPMENT AND SERVICES OF FOREIGN CONSULTANTS. LOCAL COST COMPONENT WILL FINANCE \$3.0 MILLION WORKING CAPITAL AND \$4.25 MILLION FOR MINOR EQUIPMENT AND LOCAL HANDLING, TRANSPORT CHARGES AND IMPORT DUTIES FOR IMPORTED EQUIPMENT. MOST OF DHCC'S COAL MINING MACHINERY HAS BEEN IN SERVICE ON AVERAGE OF 21 YEARS, SO PART OF NEW EQUIPMENT WILL BE FOR REPLACEMENT PURPOSES. ADDITIONAL MINING MACHINERY IS ALSO NEEDED TO EXPAND MINE PRODUCTION. SPARE PARTS FOR MINING EQUIPMENT ARE INCLUDED FOR INITIAL TWO YEARS OF OPERATION TO ENSURE CONTINUOUS RELIABLE OPERATIONS. GOVERNMENT HAS ASSURED PROVISION OF NECESSARY FOREX ALLOCATIONS FOR SPARES THEREAFTER TO ENSURE UNINTERRUPTED OPERATIONS. (SIDE LETTER LIMITED OFFICIAL USE

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NO. 4, PARA 8.)

10. PROCUREMENT CONTRACTS OF \$100,000 EQUIVALENT OR MORE WILL BE AWARDED ON BASIS OF INTERNATIONAL COMPETITIVE BIDDING; SMALLER CONTRACTS WILL BE ON BASIS REASONABLE NUMBER OF QUOTATIONS FROM MORE THAN ONE MEMBER COUNTRY. ITEMS WILL BE GROUPED SO THAT BID PACKAGES WILL BE OF APPROPRIATE SIZE FOR

ICB, WITH PRIOR BANK APPROVAL. LIMITED PROCUREMENT OF PROPRIETARY SPARE PARTS (NOT MORE THAN \$250,000 EQUIVALENT) FOR EXISTING MINING MACHINERY, WILL BE PERMITTED. CONSULTANTS WITH EXPERIENCE IN MODERN COAL MINING TECHNOLOGY WILL BE RECRUITED IN ACCORDANCE WITH BANK'S GUIDELINES TO REVIEW DHCC'S CURRENT OPERATIONS AND ASSIST IT IN PREPARATION OF LONG RANGE DEVELOPMENT PROGRAM FOR EFFICIENT AND ECONOMICAL EXPLOITATION OF COAL RESERVES AT ITS VARIOUS MINES. CONSULTANTS WILL ALSO ASSIST IN INITIAL IMPLEMENTATION OF PROJECT. ESTIMATED \$300,000 FOREX COST OF CONSULTANT SERVICES TO BE FINANCED UNDER PROPOSED LOAN.

11. DHCC, THE PROPOSED BORROWER AND EXECUTING AGENCY, IS WHOLLY GOVERNMENT-OWNED CORPORATION ESTABLISHED IN 1950. IT HAS CURRENT PAID-IN CAPITAL OF WON 10.5 BILLION (\$21.6 MILLION EQUIVALENT). DUE TO PREVIOUS GOVERNMENT POLICY OF MAINTAINING COAL PRICE AT LOW LEVEL TO PROVIDE CHEAP FUEL FOR LOWER INCOME GROUPS, DHCC'S FINANCIAL POSITION WAS UNSATISFACTORY UP TO END OF 1973, AT WHICH TIME ACCUMULATED LOSSES OF \$26.8 MILLION EQUIVALENT EXCEEDED PAID-IN CAPITAL. WITH CHANGE IN GOVERNMENT'S COAL PRICE POLICY IN 1974, WHICH GAVE INCENTIVE FOR INCREASED PRODUCTION, DHCC HAD REVENUE INCREASE OF 52.5 PERCENT IN 1974 AND, FOR FIRST TIME IN NINE YEARS, MADE NET PROFIT OF \$3.0 MILLION EQUIVALENT, EXCLUDING GOVERNMENT SUBSIDIES. DHCC'S ACCUMULATED DEFICIT, NET OF GOVERNMENT SUBSIDIES, IS PROJECTED TO BE REDUCED TO \$2.4 MILLION EQUIVALENT AT END OF 1975 AND TO BE ELIMINATED BY END OF 1976. (DHCC HAS HAD TWO PREVIOUS BORROWINGS FROM INTERNATIONAL SOURCES: LIMITED OFFICIAL USE

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\$9.5 MILLION FROM USAID IN 1963 AND DM20.72 MILLION FROM KFW IN 1964.)

12. TO ENSURE SOUND FINANCIAL POSITION, IT WAS AGREED THAT DHCC WOULD MAINTAIN: (A) DEBT/EQUITY RATIO OF NOT MORE THAN 70:30, (B) CURRENT RATIO OF NOT LESS THAN 1:25:1 AND DEBT SERVICE RATIO NOT LESS THAN 1.5:1. GOVERNMENT HAS ASSURED IT WOULD TAKE NECESSARY ACTIONS TO ENSURE MAINTENANCE BY DHCC OF STIPULATED FINANCIAL RATIOS AND REASONABLE LEVEL OF PROFITABILITY. KSIDE LETTER NO. 4, PARAS. 3-4.)

13. BANK CONSIDERS PROJECT TO BE WELL CONCEIVED, TECHNICALLY FEASIBLE AND FINANCIALLY AND ECONOMICALLY

VIALE. ECONOMIC BENEFITS OF PROJECT FROM INCREASED COAL OUTPUT AND FROM SAVINGS IN PRODUCTION COSTS ARE CONSIDERABLY HIGHER THAN ECONOMIC COSTS, AND ECONOMIC RATE OF RETURN IS ESTIMATED AT 98.8 PERCENT. PROJECTION OF CONTINUOUS HIGH COSTS FOR IMPORTED FUELS ACCENTUATES IMPORTANCE OF PROJECT TO KOREAN ECONOMY. FINANCIAL RATE OF RETURN IS ESTIMATED AT 21.4 PERCENT AFTER TAXES.

14. CUMULATIVE NET FOREX BENEFITS OVER ECONOMIC LIFE OF PROJECT ARE ESTIMATED AT ABOUT \$453 MILLION. PROJECT WILL INCREASE DOMESTIC COAL PRODUCTION BY APPROXIMATELY 11 PERCENT PER YEAR, WHICH IS ABOUT 16 PERCENT OF ESTIMATED ANTHRACITE SUPPLY GAP. PROJECT WILL HAVE SIGNIFICANT SOCIAL IMPACT BY PROVIDING LOW COST COAL TO URBAN HOUSEHOLDS RATHER THAN HIGHER COST FUEL SUBSTITUTES. IT WILL HELP TO PRESERVE LIMITED FOREST AREAS FROM BEING DENUDED FOR FIREWOOD AND WILL DECREASE ATMOSPHERIC POLLUTION BECAUSE OF LOWER SMOKE EMISSION CHARACTERISTICS OF COAL BRIQUETTES. USADB SUPPORTS PROPOSAL AND RECOMMENDS FAVORABLE NAC ACTION.

15. REQUEST SEOUL'S COMMENTS FOR NAC AGENCIES, INFO USADB MANILA, PURSUANT TO STATE 119795 DATED 3 JULY 1972.
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Message Attributes

Automatic Decaptioning: X
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Draft Date: 18 MAR 1976
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Disposition Approved on Date:
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Disposition Case Number: n/a
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Disposition Date: 28 MAY 2004
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Disposition History: n/a
Disposition Reason:
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TAGS: EAID, EFIN, KS, ADB, DAI HAN COAL CORP
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